Table of Contents

NOTE 9 — Income Taxes

Income before income taxes is as follows:

	Year Ended May 31,		
(In millions)	2012	2011	2010
Income before income taxes:			
United States	$ 792	$ 1,084	$ 699
Foreign	2,191	1,760	1,818
TOTAL INCOME BEFORE INCOME TAXES	**$ 2,983**	**$ 2,844**	**$ 2,517**

The provision for income taxes is as follows:

	Year Ended May 31,		
(In millions)	2012	2011	2010
Current:			
United States			
Federal	$ 274	$ 289	$ 200
State	51	57	50
Foreign	495	441	349
Total	820	787	599
Deferred:			
United States			
Federal	(54)	(61)	18
State	4	—	(1)
Foreign	(10)	(15)	(6)
Total	(60)	(76)	11
TOTAL INCOME TAX EXPENSE	**$ 760**	**$ 711**	**$ 610**

A reconciliation from the U.S. statutory federal income tax rate to the effective income tax rate follows:

	Year Ended May 31,		
	2012	2011	2010
Federal income tax rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	1.3%	1.3%	1.3%
Foreign earnings	-11.5%	-10.5%	-12.7%
Other, net	0.7%	-0.8%	0.6%
EFFECTIVE INCOME TAX RATE	**25.5%**	**25.0%**	**24.2%**

The effective tax rate for fiscal 2012 was 50 basis points higher than the effective tax rate for fiscal 2011 primarily due to changes in uncertain tax positions, partially offset by a reduction in the effective tax rate on operations outside of the United States as a result of changes in geographical mix of foreign earnings. The effective tax rate for fiscal 2011 was 80 basis points higher than the effective tax rate for fiscal 2010 primarily due to the change in geographic mix of earnings. A larger percentage of our earnings in fiscal 2011 were attributable to operations in the U.S., where the statutory tax rate is generally higher than the effective tax rate on operations outside of the U.S. This impact was partially offset by changes to uncertain tax positions.

Table of Contents

Deferred tax assets and (liabilities) are comprised of the following:

	May 31,	
(In millions)	2012	2011
Deferred tax assets:		
Allowance for doubtful accounts	$ 18	$ 19
Inventories	40	63
Sales return reserves	85	72
Deferred compensation	177	152
Stock-based compensation	144	148
Reserves and accrued liabilities	68	66
Foreign loss carry-forwards	76	60
Foreign tax credit carry-forwards	216	236
Hedges	—	21
Undistributed earnings of foreign subsidiaries	82	—
Other	71	86
Total deferred tax assets	977	923
Valuation allowance	(81)	(51)
Total deferred tax assets after valuation allowance	896	872
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	—	(40)
Property, plant and equipment	(186)	(151)
Intangibles	(98)	(97)
Other	(21)	(21)
Total deferred tax liability	(305)	(309)
NET DEFERRED TAX ASSET	$ 591	$ 563

The following is a reconciliation of the changes in the gross balance of unrecognized tax benefits, excluding interest and penalties:

	May 31,		
(In millions)	2012	2011	2010
Unrecognized tax benefits, as of the beginning of the period	$ 212	$ 282	$ 274
Gross increases related to prior period tax positions	48	13	87
Gross decreases related to prior period tax positions	(25)	(98)	(122)
Gross increases related to current period tax positions	91	59	52
Gross decreases related to current period tax positions	(1)	(6)	—
Settlements	(20)	(43)	(3)
Lapse of statute of limitations	(9)	(8)	(9)
Changes due to currency translation	(11)	13	3
UNRECOGNIZED TAX BENEFITS, AS OF THE END OF THE PERIOD	$ 285	$ 212	$ 282

As of May 31, 2012, the total gross unrecognized tax benefits, excluding related interest and penalties, were $285 million, $165 million of which would affect the Company's effective tax rate if recognized in future periods.

The Company recognizes interest and penalties related to income tax matters in income tax expense. The liability for payment of interest and penalties increased $17 million, $10 million, and $6 million during the years ended May 31, 2012, 2011, and 2010, respectively. As of May 31, 2012 and 2011, accrued interest and penalties related to uncertain tax positions were $108 million and $91 million, respectively (excluding federal benefit).

The Company is subject to taxation primarily in the U.S., China, the Netherlands, and Brazil, as well as various state and other foreign jurisdictions. The Company has concluded substantially all U.S. federal income tax matters through fiscal year 2010. The Company is currently under audit by the Internal Revenue Service for the 2011 and 2012 tax years. The Company's major foreign jurisdictions, China, the Netherlands and Brazil, have concluded substantially all income tax matters through calendar 2001, fiscal 2006 and calendar 2004, respectively. The Company estimates that it is reasonably possible that the total gross unrecognized tax benefits could decrease by up to $58 million within the next 12 months as a result of resolutions of global tax examinations and the expiration of applicable statutes of limitations.

The Company has indefinitely reinvested approximately $5.5 billion of the cumulative undistributed earnings of certain foreign subsidiaries. Such earnings would be subject to U.S. taxation if repatriated to the U.S. The amount of unrecognized deferred tax liability associated with the indefinitely reinvested undistributed earnings at May 31, 2012 is $1.8 billion.

A portion of the Company's foreign operations are benefitting from tax holidays that will phase out in fiscal 2019 and fiscal 2021. These tax holidays may be extended when certain conditions are met or may be terminated early if certain conditions are not met. The decrease in income tax expense for the year ended May 31, 2012 as a result of these arrangements was approximately $103 million ($0.22 per diluted share) and $36 million ($0.07 per diluted share) for the year ended May 31, 2011.

Deferred tax assets at May 31, 2012 and 2011 were reduced by a valuation allowance relating to tax benefits of certain subsidiaries with operating losses. The net change in the valuation allowance was an increase of $30 million and $15 million for the years ended May 31, 2012 and 2011, respectively.